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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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IN THE MATTER OF THE APPLICATION OF
UNS ELECTRIC, INC. FOR AN ACCOUNTING
ORDER IN CONNECTION WITH THE
ACQUISITION OF UP TO A 25% INTEREST IN
GILA RIVER POWER PLANT UNIT 3.

DOCKET NO. E-04204A-13- 0476

APPLICATION

UNS Electric, Inc. ("UNSE" or "Company") requests that the Arizona Corporation Commission ("Commission") approve an accounting order authorizing the deferral for future recovery of non-fuel costs associated with the Company's prospective purchase of up to a 25% interest in Unit 3 at the Gila River Power Plant ("Unit 3" or the "Plant"). These costs would include depreciation and amortization costs, property taxes, O&M expenses and carrying costs associated with owning, operating and maintaining the Plant.

This proposed order would allow UNSE to address its need for base load generation through the timely acquisition of a uniquely appropriate resource without compromising the Company's financial stability. UNSE's share of this efficient, combined cycle natural gas-fired unit would be purchased at a reasonable price which is only possible through an opportune partnership with sister company Tucson Electric Power ("TEP"). The Plant would provide near-term benefits to UNSE customers through lower purchased power costs and reduced exposure to potentially volatile market power prices. The proposed accounting order also would help UNSE maintain its investment-grade credit rating during the cost deferral period. For these and other reasons, the public interest would be served by the Commission's approval of the proposed accounting order described in greater detail below.



1 **I. UNSE'S CURRENT GENERATING PORTFOLIO.**

2 UNSE currently lacks base load generation. The Company serves its 93,000 customers
3 primarily with power purchased from the wholesale energy and capacity market. Its generation
4 assets are limited to simple cycle natural gas-fired combustion turbines used primarily for on-peak
5 power and reserve capacity. These include the Black Mountain Generating Station, a Mohave
6 County facility equipped with twin 45-megawatt ("MW") turbines, and the Valencia Generating
7 Station in Nogales, which includes four 14-MW turbines.

8 UNSE's heavy reliance on wholesale power has not proven problematic in recent years
9 where affordably priced resources have been widely available. Over the long term, though, the
10 Company's customers could face significantly higher rates and potential reliability concerns if coal
11 plant closures, carbon costs, increased growth rates or other market forces drive up energy and
12 capacity costs and restrict the availability of market resources. The Commission acknowledged
13 this risk in May 2013 when it advised UNSE and other load serving entities about future short-
14 term market purchases in their long-term Integrated Resource Plans ("IRPs"):

15 *The cost and availability of such purchases are subject to a wide array of*
16 *influences that are difficult, if not impossible to predict. For example, if a large*
17 *number of older coal-fired generating plants are retired in the western region, the*
18 *availability of such purchases will decline dramatically, and the cost of such*
purchases will increase significantly. Reliance on short term market purchases in
a long-term plan is difficult, if not impossible, to justify. (Decision No. 73884,
Page 4)

19 For similar reasons, UNSE's 2012 IRP establishes the Company's need for base load
20 resources. While the plan projects that energy efficiency programs will reduce the Company's
21 combined retail load and reserve margin from 511 MW in 2013 to 469 MW by 2023, it
22 nonetheless calls for new base load resources to stabilize UNSE's long-term energy outlook.
23 Citing the high cost of new construction and UNSE's relatively modest base load energy needs, the
24 plan instead identifies an interest in a particular type of acquisition:

25 *UNS Electric will monitor the market for economically attractive plant*
26 *acquisition opportunities. A low cost, multi-owner acquisition of an existing*
27 *combined cycle gas fired plant would enable UNS Electric to firm up its longer-*
term capacity needs while realizing economies of scale through a multi-owner
plant configuration (UNSE IRP at Page 13)

II. THE PLANNED ACQUISITION.

The planned acquisition of Unit 3 would satisfy UNSE's base load energy needs under the precise circumstances articulated in the Company's 2012 IRP. Under terms of the Asset Purchase and Sale Agreement ("Agreement"), TEP and UNSE would purchase the 550-MW unit for approximately \$219 million. UNSE's share of this purchase price would be approximately \$55 million, or Approximately \$398 per kW.¹ UNSE and TEP also would secure transmission rights necessary to deliver the plant's output to transmission hubs linked to their respective service territories in Mohave, Santa Cruz and Pima Counties. In this way, the purchase would provide UNSE with a stable, efficient source for 30 to 40 percent of its long term capacity needs, reducing its reliance on the wholesale market and helping the Company reliably integrate an increasing share of renewable resources into its portfolio.

Unit 3 is uniquely well suited for these tasks. The Plant is located approximately 75 miles southwest of Phoenix and about 30 miles south of the Palo Verde trading hub – nearly equidistant from UNSE's Mohave County and Santa Cruz County service areas. The Plant is linked to the Palo Verde hub by a pair of 500-kilovolt (kV) transmission lines with firm, long-term transmission rights to the Jojoba Switchyard. The Plant also can be served by both the El Paso Natural Gas and Transwestern Pipeline Company, L.L.C., which provide competitive access to the Permian, San Juan and Anadarko supply basins.

The 10-year-old, 2,200 MW Gila River Power Plant includes four 550-MW power blocks, making it the largest natural gas-fired generating facility in the Western Electric Coordinating Council ("WECC") market zone. The Plant also is one of the most efficient combined cycle plants in the WECC region, with a heat rate of approximately 7,000 British thermal units ("BTUs") per

¹ On December 23, 2013, TEP and UNSE entered into the Agreement to purchase Gila River Unit 3 for \$219 million. The purchase price is subject to adjustments to prorate certain fees and expenses through the closing and in respect of certain operational matters. It is anticipated that TEP will purchase a 75% undivided interest in Gila River Unit 3 for approximately \$164 million and that UNSE will purchase the remaining 25% undivided interest for approximately \$55 million, although TEP and UNSE may modify the percentage ownership allocation between them. TEP and UNSE expect the transaction to close no later than December 2014, assuming FERC approval and satisfaction of other transaction contingencies.

1 kilowatt-hour ("kWh"). At that heat rate, the Plant generates power more efficiently than the
2 average resource available on the wholesale market and easily bests UNSE's simple cycle
3 combustion turbines, which operate at heat rates ranging from 9,800 to 16,000 BTU/kWh.

4 UNSE's opportunity to purchase a share of the plant arose after TEP issued a request for
5 proposals ("RFP") in May 2013 for generating resources in accordance with the Commission's
6 IRP Rules.² Gila River Power L.L.C. ("Gila River Power"), a subsidiary – through several
7 intermediaries – of Entegra Power Group L.L.C., and owner of Units 3 and 4 at the Plant,
8 responded to the RFP with an offer to sell Unit 3. After reviewing that offer and other available
9 options, TEP concluded that ownership of the Plant would serve the best interests of UNSE and its
10 customers. Additionally, based on the large size of the Plant and the base load needs of UNSE, it
11 was determined that joint ownership of the Plant would be in the best interest of both UNSE and
12 TEP and their respective customers. A comparison of the capital costs and life-cycle levelized
13 costs of the proposed acquisition versus other alternatives, attached as **Exhibit 1**, shows the
14 purchase will prove far less expensive than a similar commitment in a newly constructed
15 combined cycle plant, resulting in \$136 million of net present value for UNSE customers.

16 If the proposed purchase is finalized and approved by the Federal Energy Regulatory
17 Commission ("FERC")³, the Plant would continue to be operated by Gila Bend Operations
18 Company, L.L.C. ("GBOC"), a special purpose entity created through a joint ownership agreement
19 between Gila River Power and Sundevil Power Holdings L.L.C., owner of Units 1 and 2. The
20 GBOC limited liability company agreement will be amended at closing of the Agreement to
21 reflect TEP's and UNSE's joint ownership of Unit 3 and corresponding twenty-five percent (25%)
22 joint ownership interest in GBOC. Other terms and conditions of the proposed acquisition are
23 contained in the Agreement.

24
25

26 ² A.A.C. R14-2-701 through R14-2-706.

27 ³ UNSE, together with TEP and Gila River Power, will seek approval by FERC under Section 203 of the
Federal Power Act of 1935 and Part 33 of the FERC Regulations. APS also will transfer 550 MW of long-
term firm point-to-point transmission service on the 500-kV transmission lines to Jojoba to UNS Electric
and TEP.

1 For TEP, the purchase represents a well-measured step to diversify a generation portfolio
2 that currently exceeds 2,000 MW of company-owned capacity. The acquisition would help offset
3 the reduction in capacity resulting from TEP's decision to purchase only a portion of its leased
4 interest in Unit 1 at the Springerville Generating Station as well as the potential loss of capacity
5 resulting from the prospective closure of Unit 2 at the San Juan Generating Station.

6 For UNSE, a much smaller company, the proposed acquisition represents a more
7 substantial financial commitment on a relative basis. The purchase price would represent nearly 28
8 percent of the original cost rate base approved in the Company's recently completed rate case.
9 Without action by the Commission, UNSE would incur substantial costs without any prospect of
10 future recovery until the Plant is reflected in non-fuel rates in the Company's next general rate
11 case.

12 **III. THE COMPANY'S REQUEST.**

13 To facilitate this planned purchase, UNSE requests that the Commission approve an
14 accounting order authorizing the Company to defer for future recovery specific non-fuel costs
15 related to its planned ownership stake in the Plant, including: (i) depreciation and amortization
16 costs, (ii) property taxes, (iii) O&M expenses, (iv) a carrying cost on the Plant investment
17 ("carrying costs"), and (v) any other non-fuel Plant costs. UNSE expects these costs will total
18 approximately \$9 million by the end of 2015. Upon approval of this request and completion of the
19 sale, the Company would record a regulatory asset in accordance with relevant FERC and
20 accounting standards to defer those costs until the Company's interest in the Plant is put into rate
21 base in UNSE's next rate case.

22 Depreciation would be calculated based on the expected useful life of the Plant, while the
23 O&M and property taxes deferred would reflect the actual amounts incurred. UNSE requests
24 deferral of carrying costs based on the average cost of debt of 5.97% approved by the Commission
25 at its December 17, 2013 Open Meeting in connection with UNSE's recent rate case (Docket No.
26 E-04204A-12-0504). Although UNSE intends to use a combination of debt and equity capital to
27 finance the purchase of its share of the Plant, the Company is willing to use its average cost of debt

1 for the purpose of calculating carrying costs, which would result in a lower balance of deferred
2 costs subject to future rate recovery.

3 This proposed accounting order is permitted under FERC Uniform System of Accounts
4 ("USOA") guidelines,⁴ which the Commission has adopted as part of its regulation of electric
5 utilities.⁵ The Commission has approved similar orders for APS in association with its 2005
6 acquisition of the Sundance Generating Station in Coolidge and, more recently, its plan to acquire
7 Southern California Edison's share in Four Corners Generating Station ("Four Corners") Units 4
8 and 5 while retiring Units 1 through 3.⁶

9 In this case, the accounting order would serve the public interest by supporting UNSE's
10 financial stability and investment-grade credit rating until the Plant's costs could be addressed in a
11 future rate case. The Company's debt obligations are currently rated Baa2 by Moody's Investor
12 Service ("Moody's"). The accounting order would be important from the standpoint of perceived
13 level of regulatory support for UNSE, a key factor considered by Moody's and others in evaluating
14 the Company's creditworthiness. Without such treatment, the planned purchase of the Plant would
15 impose undue and potentially untenable financial burdens on UNSE given the size of the planned
16 investment relative to the Company's current capitalization.

17 Approval of the proposed accounting order also would strike an appropriate balance
18 between the Company's shareholders and UNSE's customers. Upon closing of the planned
19 purchase, the Company's customers would benefit from the reduction in purchased power
20 expenses that would result from the Plant's acquisition. The resulting savings would be passed
21

22 ⁴ See e.g. FERC Order 552 (Docket No. RM92-1) (March 31, 1993) (allowing for the creation of
23 regulatory assets and liabilities through actions of regulatory agencies – establishing FERC Accounts
182.3 and 254).

24 ⁵ See A.A.C. R14-2-212(G)(2).

25 ⁶ See Decision No. 67504 (January 20, 2005) (regarding Sundance Generating Station) and Decision No.
26 73130 (Four Corners Generating Station). In accordance with *Accounting Standards Codification (ASC)*
27 980 – *Regulated Operations*, UNS Electric may defer the capitalized costs as a regulatory asset under
Generally Accepted Accounting Principles ("GAAP") only if it is probable that the Company will be
allowed to recover them through future rates; otherwise, such costs must be recorded as an expense.
Consequently, UNS Electric seeks language similar to what was provided for APS in Decision No. 73130
(April 24, 2012).

1 onto UNSE customers almost immediately through operation of the 12-month rolling average
2 provision in UNSE's new Purchased Power and Fuel Adjustment Clause ("PPFAC").⁷ Preserving
3 the Company's ability to recover the non-fuel Plant costs during this same period therefore would
4 strike an appropriate balance between shareholders and customers.

5 The accounting order also would facilitate a transaction that creates significant long-term
6 benefits for UNSE's customers. As noted above, this opportune partnership with TEP provides
7 access to a right-sized share of an efficient, combined-cycle natural gas fired plant that is uniquely
8 situated to serve its long-term base load energy needs. UNSE would be unable to build or purchase
9 a comparable resource without such a partnership, and the unique benefits provided by this Plant
10 are simply unavailable outside of this transaction.

11 In conclusion, the public interest would be well served by the Commission's approval of an
12 accounting order that would facilitate UNSE's planned acquisition of a 25% stake in Unit 3 at the
13 Gila River Power Plant.

14 **IV. PROPOSED ORDERING LANGUAGE.**

15 UNSE requests approval of the language below, which is modeled after the Commission's
16 order in Decision No. 73130 regarding APS's Four Corners acquisition. The proposed language
17 would make clear that UNSE is authorized to defer certain costs associated with the purchase and
18 operation of Unit 3 for future recovery. The language is intended to provide UNSE with a
19 reasonable assurance of recovery, subject to review for reasonableness and prudence, so the
20 Company can record those costs as a regulatory asset in accordance with GAAP requirements.
21 UNSE also would agree to the reporting requirements contained in Decision No. 73130 and
22 provided below:

23 IT IS THEREFORE ORDERED that UNS Electric, Inc. is authorized to
24 defer for possible later recovery through rates, all non-fuel costs (as defined herein)
25 of owning, operating and maintaining up to an acquired 25 percent interest in Gila
26 River Power Plant Unit 3 and associated facilities. Nothing in this Decision shall

27 ⁷ Any purchased power savings not yet passed along to customers by the time UNSE's next rate case is resolved could be used to offset any approved increase in base rates in that matter.

1 be construed in any way to limit this Commission's authority to review the entirety
2 of the acquisition and to make any disallowances thereof due to imprudence, errors
or inappropriate application of the requirements of this Decision.

3 IT IS FURTHER ORDERED that UNS Electric, Inc. shall reduce the
4 deferrals by any fuel and purchased power savings and off-system sales not
5 otherwise reflected in its Purchased Power and Fuel Adjustment Clause.

6 IT IS FURTHER ORDERED that the accumulated deferred balance
7 associated with all amounts deferred pursuant to this Decision will be included in
8 the cost of service for rate-making purposes in UNS Electric, Inc.'s next general
9 rate case. Nothing in this Decision shall be construed to limit this Commission's
authority to review such balance and to make disallowances thereof due to
imprudence, errors or inappropriate allocation of the requirements of this Decision.

10 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare and
11 retain accounting records sufficient to permit detailed review, in a rate proceeding,
of all deferred costs and cost benefits as authorized herein.

12 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare a
13 separate detailed report of all costs deferred under this authorization and shall
14 include that report as an integral component of each of its general rate applications
15 in which requests recovery of those deferred costs.

16 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file an annual
17 status report for each preceding calendar year, of all matters related to the deferrals,
18 and the cumulative costs thereof every April 1 with Docket Control, as a
19 compliance item in this Docket, with the first such report due not later than April 1,
20 2015.

21 V. CONCLUSION.

22 UNSE requests that the Commission: (i) authorize the Company to defer for future
23 recovery non-fuel costs associated with acquiring, operating and maintaining up to a 25% share of
24 Gila River Power Plant Unit 3, and (ii) issue an order by end of the third quarter of 2014 consistent
25 with the proposed language provided in Section IV. UNSE also requests that the Commission
26 provide any other relief necessary to allow such deferral and future recovery.
27

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1 RESPECTFULLY SUBMITTED this 31st day of December, 2013.

2 UNS ELECTRIC, INC.

3
4 By 

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16 Original and 13 copies of the foregoing
filed this 31st day of December, 2013 with:

17 Docket Control
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19 Phoenix, Arizona 85007

20 Copies of the foregoing hand-delivered/mailed
this 31st day of December 2013 to the following:

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Exhibit 1

Unit Capacity (MW)	137.5
Weighted Average Cost of Capital	7.83%
Levelized Cost of Fuel (\$/mmBtu)	\$6.54
Average Capacity Factor	41.7%

	Gila River Acquisition	New Build Construction Costs
Cost of Installed Capacity	\$54,750	\$181,500
Cost of Installed Capacity (\$/kW)	\$398	\$1,320
NPV Revenue Requirements	\$323,850,664	\$459,643,777
Levelized Cost of Energy (\$/MWh)	\$79.72	\$113.14

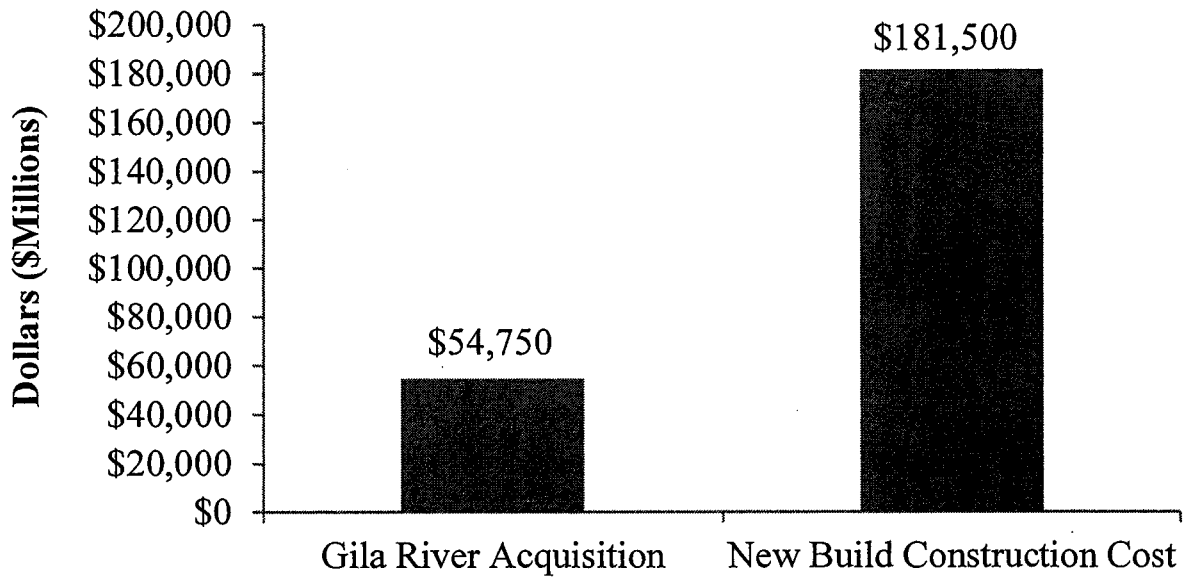
NPV Revenue Requirement Savings	\$135,793,113
---------------------------------	---------------

The 15-year revenue requirement and levelized cost of energy are based on a 2015-2029 forecast, excluding any future carbon legislation costs.

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Unit Acquisition Cost



COMMISSIONERS

GARY PIERCE- CHAIRMAN
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PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-04204A-13-0476
 UNS ELECTRIC, INC. FOR AN ACCOUNTING)
 ORDER IN CONNECTION WITH THE)
 ACQUISITION OF UP TO A 25% INTEREST IN)
 GILA RIVER POWER PLANT UNIT 3.)

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Electric, Inc.

December 5, 2014

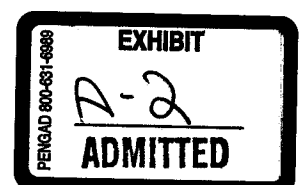


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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and business address.**

4 A. My name is Dallas J. Dukes and my business address is 88 East Broadway Blvd.,
5 Tucson, Arizona 85701.
6

7 **Q. By whom are you employed and what are your duties and responsibilities?**

8 A. I am the Senior Director of Pricing and Economic Forecasting for Tucson Electric
9 Power Company ("TEP"). I am responsible for monitoring and determining revenue
10 requirements, customer pricing and rates structures for all the regulated subsidiaries of
11 UNS Energy Corporation ("UNS Energy"), including UNS Electric, Inc. ("UNS
12 Electric" or the "Company").
13

14 **Q. What is the purpose of your direct testimony?**

15 A. In my testimony, I will provide: (i) an overview of the Company's request for an
16 accounting order authorizing the deferral for future recovery of non-fuel costs associated
17 with its prospective purchase of up to 25% interest in Unit 3 at the Gila River Power
18 Plant ("Unit 3" or the "Plant") including the numerous benefits that UNS Electric and its
19 customers will receive from the acquisition; (ii) a response to Staff's accounting order
20 proposal contained in the Direct Testimony of Gerald Becker, which was filed in the
21 docket on October 28, 2014; and (iii) how the Company's request meets the standard for
22 an accounting order.
23

24 **Q. Please summarize the Company's request in this docket.**

25 A. UNS Electric filed its Application on December 31, 2013 because the Company has a
26 unique opportunity to address its need for base load generation by acquiring a portion of
27 an efficient, combined-cycle natural-gas-fired unit at a reasonable price. In the

1 Application, UNS Electric requested to defer costs including depreciation and
2 amortization, property taxes, O&M expenses, and carrying costs associated with owning,
3 operating and maintaining the Plant. An accounting order would preserve UNS Electric's
4 financial integrity and help the Company maintain its investment-grade credit rating
5 during the cost deferral period. Based on conversations with Staff, UNS Electric revised
6 its request, which I detail later in my testimony and which Staff summarized in its pre-
7 filed testimony.

8
9 **II. THE ACQUISITION AND BENEFITS OF UNIT 3.**

10
11 **Q. Please provide a general description of the Gila River Power Plant.**

12 A. The Gila River Power Plant is located approximately 75 miles southwest of Phoenix and
13 about 30 miles south of the Palo Verde trading hub. It is nearly equidistant from UNS
14 Electric's Mohave County and Santa Cruz County service areas, and rests on
15 approximately 1,100 acres within the Gila Bend town-site. The Plant consists of four
16 "power blocks," with each block representing 550 MW of nominal capacity. At 2,200
17 MW of combined capacity, Gila River is the largest natural gas-fired generating facility
18 in the Western Electric Coordinating Council ("WECC") market zone. The Plant was
19 constructed in four phases, with all phases completed in mid-to-late 2003. Unit 3 was
20 completed in July 2003. The Plant is within its own generation-only balancing authority.

21
22 **Q. Why is UNS Electric's acquisition of the portion of Unit 3 important to its resource**
23 **portfolio?**

24 A. As described in UNS Electric's 2014 Integrated Resource Plan¹ ("2014 IRP"), the
25 Company currently relies on the wholesale market for approximately 85%, or 300 – 325
26 MW, of its annual resource capacity needs. With the planned acquisition of 25% of Unit
27

¹ Filed on April 1, 2014 in Docket No. E-00000V-13-0070.

1 3, UNS Electric will reduce its market-based capacity exposure by 45%. As stated in the
2 Company's Application, UNS Electric's heavy reliance on wholesale power has not
3 proven problematic in recent years when natural gas prices and capacity values have
4 remained low. Over the long term, though, the Company's customers could face
5 significantly higher rates and potential reliability concerns as proposed coal plant
6 closures, carbon costs, increased growth rates and other market forces drive up energy
7 and capacity costs and reduce the availability of low cost market resources. This risk was
8 acknowledged by the Commission in May 2013 when it advised the Company and other
9 load serving entities of the challenges future short-term market purchases in their long-
10 term Integrated Resource Plans could create:

11 *The cost and availability of such purchases are subject to a wide array*
12 *of influences that are difficult, if not impossible to predict. For example,*
13 *if a large number of older coal-fired generating plants are retired in the*
14 *western region, the availability of such purchases will decline*
dramatically, and the cost of such purchases will increase significantly.
Reliance on short term market purchases in a long-term plan is difficult,
if not impossible, to justify. (Decision No. 73884, Page 4)

15
16 **Q. Does the Plant's location provide other benefits to UNS Electric?**

17 **A.** Yes. One significant advantage of the Gila River Power Plant is its proximity to
18 transmission and natural gas supplies. The Plant is linked to the Palo Verde hub and is
19 interconnected to the extra-high-voltage ("EHV") transmission grid through a pair of 500
20 kilovolt (kV) lines with firm, long-term transmission rights to the Jojoba Switchyard.
21 Gila River Power Plant also has access to natural gas from two different suppliers. The
22 Plant has connections to both El Paso Natural Gas (EPNG) and Transwestern Pipeline
23 Company, L.L.C. ("Transwestern") systems. Through the EPNG and Transwestern
24 systems, the Plant has access to the Permian, San Juan, West Texas, and Waha gas
25 supply. Unit 3's access to transmission means that delivery to UNS Electric's service
26 territories is not an issue. Moreover, access to natural gas supplies means that the Plant
27 will reliably serve those customers under a vast majority of circumstances.

1
2 **Q. How efficient is Gila River Power Plant?**

3 A. It is one of the most efficient combined-cycle plants in the WECC region with a heat rate
4 of approximately 7,000 British thermal units ("BTUs") per kilowatt-hour ("kWh"). This
5 is significantly more efficient than UNS Electric's simple-cycle combustion turbines
6 (operating at heat rates from 9,800 to 16,000 BTUs/kWh). Unit 3 provides a solid base
7 load resource by reducing the overall heat-rate when compared to market heat rates and
8 existing assets.
9

10 **Q. How did UNS Electric identify the opportunity to acquire 25% of Unit 3?**

11 A. As set forth in the Application, the opportunity for UNS Electric to acquire a share of
12 Unit 3 was the result of a request for proposals ("RFP") that UNS Electric's sister utility,
13 Tucson Electric Power Company ("TEP") issued in May 2013. The RFP was issued in
14 accordance with the Commission's Integrated Resource Planning Rules at A.A.C. R14-2-
15 701 through R14-2-706.² TEP concluded that ownership of Unit 3 was the best option
16 compared to other options, but that joint ownership with UNS Electric would be in their
17 mutual best interests (given the size of Unit 3 and the Company's need for base load
18 resources). The competitive bidding process held by TEP further demonstrates the cost-
19 effectiveness of Unit 3 to UNS Electric.
20

21 **Q. Do you believe that acquiring 25% of Unit 3 is the least expensive option for UNS**
22 **Electric to acquire a substantial base load resource?**

23 A. Yes. As stated in the Company's Application, the acquisition of 25% of Unit 3 will be far
24 less expensive than a similar commitment in a newly-constructed combined-cycle plant.³
25 The Plant's location, proximity to transmission and natural gas pipelines, and heat
26

27 ² Specifically, A.A.C. R14-2-705.B provides that a "load-serving entity shall use an RFP process as its primary acquisition process for the wholesale acquisition of energy and capacity. . . ."

³ See Application (December 31, 2013) at Exhibit 1.

1 efficiencies will give the Company a reliable base load resource that bests comparable
2 resources available on the wholesale market, as demonstrated by the procurement
3 process.
4

5 **Q. Do you believe that these benefits warrant allowing UNS Electric to defer the costs**
6 **of acquiring its 25% portion of Unit 3?**

7 A. Yes. This is an excellent opportunity for UNS Electric to acquire a base load resource at a
8 very reasonable price. I also note that this would significantly mitigate the risks
9 associated with relying too heavily on the wholesale market to supply power to
10 customers. UNS Electric noted in its Application a need for base load resources in its
11 2012 IRP (and confirmed that in its 2014 IRP), and that it will monitor the market for
12 opportunities, including acquiring a low-cost, multi-owner acquisition of an existing
13 combine-cycle gas-fired plant to firm up long-term capacity needs.⁴ In short, acquiring
14 25% of Unit 3 provides UNS Electric with a stable, efficient resource for up to 40% of its
15 long-term capacity needs, reducing its reliance on the wholesale market, giving it access
16 to a right-sized share of a resource uniquely-situated to serve its needs and an opportune
17 partnership with its sister company, TEP. These benefits simply cannot be found
18 elsewhere.
19

20 **Q. What would be the impact to UNS Electric's financial condition if it was unable to**
21 **defer costs related to the purchase of Unit 3?**

22 A. Unit 3 is a significant investment for UNS Electric. The purchase price of approximately
23 \$55 million represents about 28% of the original cost rate base established in the
24 Company's last general rate case. The non-fuel operating costs associated with the
25 Company's purchase of Unit 3 are expected to be approximately \$9 million by the end of
26 2015. To put this into context, if Unit 3 had been purchased in January 2013, UNS
27

⁴ See Application at 2.

1 Electric's reported net income would have fallen by approximately 42% without any cost
2 deferral. Preserving UNS Electric's financial condition during the deferral period is in
3 the public interest.
4

5 **Q. Would the accounting order help the Company maintain its current credit rating?**

6 A. Yes. The Company's debt obligations are currently rated Baa1⁵ by Moody's Investor
7 Service ("Moody's"). The accounting order would be important from the standpoint of
8 perceived level of regulatory support for UNS Electric - a key factor considered by
9 Moody's and others in evaluating the Company's creditworthiness. Without such
10 treatment, the planned purchase of the Plant would impose undue and potentially
11 untenable financial burdens on UNS Electric given the size of the planned investment
12 relative to the Company's current capitalization.
13

14 **III. COMMENTS ON THE STAFF TESTIMONY.**
15

16 **Q. Have you reviewed the pre-filed testimony of Staff witness Gerald Becker docketed**
17 **on October 28, 2014?**

18 A. Yes I have.
19

20 **Q. What was Staff's recommendation regarding UNS Electric's deferral request?**

21 A. Staff describes the revision to the Company's request that the Company provided to Staff
22 on September 15, 2014 via email. Specifically, the Company's amended request was as
23 follows:

- 24 • The non-fuel costs associated with owning, operating and maintaining UNSE's share
25 of Unit 3 shall be deferred including: O&M expenses, depreciation and amortization
26

27

⁵ UNSE's rating has been upgraded from Baa2 since the Company filed its Application.

1 expense, property taxes and carrying costs. Carrying costs are to be accrued on the
2 Company's investment in the Plant at a debt cost of 5.0%.

- 3 • The reductions to UNSE's purchased energy and capacity costs would be retained by
4 the Company from the purchase date (presumably no later than January 2015).
5 through the date on which the Plant is placed into rate base upon completion of the
6 Company's next rate case.
- 7 • During this period, the purchased energy and capacity savings would serve to off-set
8 all, or a portion of, the increase in the Company's non-fuel costs associated with
9 owning and operating Unit 3. These costs include O&M expense, depreciation and
10 amortization expense, property taxes and carrying costs.
- 11 • Upon completion of the Company's next rate case, the ongoing energy and capacity
12 cost savings provided by Unit 3 would be passed onto customers, thus mitigating an
13 expected future increase in the Company's non-fuel base rates.
- 14 • The purchased energy cost savings shall be calculated monthly based on the
15 difference between the actual Unit 3 fuel costs (net of revenues from short-term
16 wholesale sales) and the market value of Unit 3 energy production used to serve retail
17 load (calculated using published on and off-peak market prices from the
18 Intercontinental Exchange ("ICE").)
- 19 • The avoided cost of capacity purchases shall be \$1.52 per kW/month, which is based
20 on third-party quotes for 2015 demand (capacity) options, which is approximately
21 \$2.5 million on an annual basis.
- 22 • The margin from short-term wholesale sales shall be based on revenues from short-
23 term wholesale sales less the actual fuel costs for Unit 3 allocated to wholesale sales.
- 24 • The reductions to UNS Electric's purchased energy and capacity costs, and the
25 increases in the margin on short-term wholesale sales, resulting from the ownership
26 of Unit 3, shall be calculated monthly.

- 1 • The amount of these cost savings recovered through UNSE's PPFAC shall not be
2 included in the Accumulated PPFAC Bank Balance for purposes of calculating
3 accrued interest.

4 Staff agrees that the net benefit of any wholesale value arising from the ownership of
5 Unit 3 should be deferred. Staff also recommended a clarification of the calculation of
6 the cost savings.

7
8 **Q. What are the benefits of the deferral proposed by Staff?**

9 A. The proposal in Staff's testimony reflects discussions between Staff, RUCO and the
10 Company. Although the proposal is somewhat different than what the Company initially
11 proposed, there are several benefits to this approach, including (i) a better matching of
12 customer savings with the costs associated with owning and operating Unit 3, (ii)
13 mitigation of the initial customer rate impact expected to result from UNS Electric's next
14 rate case and (iii) improved cash flow for UNS Electric during the cost deferral period,
15 which should further support the Company's investment grade credit rating.

16
17 **Q. Has the Company prepared a Plan of Administration as requested in the Staff**
18 **Testimony?**

19 A. As of the filing of this testimony, the Company is working with Staff and RUCO to
20 develop a Plan of Administration ("POA"). The Company intends to finalize the POA
21 with Staff and RUCO, and file it before the hearing on December 15, 2014.

22
23 **Q. What is your response to Staff's clarification of the savings?**

24 A. The POA will clarify the definition of savings.
25
26
27

1 **Q. Staff also recommends time and dollar limitations to the cost deferral authorization**
2 **(specifically that any deferral will cease on May 1, 2016 and be no more than \$10.5**
3 **million). Does the Company support those recommendations?**

4 **A.** The Company's Application did not include these types of limitations. However, UNS
5 Electric does not oppose Staff's recommendations regarding a cap for the deferral amount
6 and an end date for the deferral period. From a customer perspective, this is another
7 benefit of the deferral mechanism recommended by Staff.
8

9 **Q. Staff also indicates the costs eligible for deferral must be specified and not be open-**
10 **ended to include any "other non-fuel plant costs." What is UNS Electric's**
11 **response?**

12 **A.** The Company does not oppose excluding "other non-fuel plant costs" from the costs
13 eligible for deferral. However, the deferral needs to include, as outlined in Staff's
14 testimony,⁶ O&M expense, depreciation and amortization expense, property taxes and
15 carrying costs.
16

17 **Q. Could you clarify the Company position with regards to Decision No. 73884?**

18 **A.** Yes. In Decision No. 73884, the Commission acknowledged UNS Electric's 2012
19 Integrated Resource Plan as provided for in the IRP rules. UNS Electric agrees Decision
20 No. 73884 did not order it to purchase generation. However, the Company wanted to
21 point out that the Decision highlighted the concern regarding over-reliance on short-term
22 market purchases and that the Commission acknowledged that risk. *One* of the ways to
23 reduce that reliance is to acquire a base load resource. This is a major reason why
24 acquiring Unit 3 is important to UNS Electric and why the Company seeks the
25 accounting order – so that the Company can acquire a highly efficient generation asset at
26 a reasonable price. In short, the acquisition is in the best interest of our customers and
27

⁶ See Staff Testimony at 7-8.

1 the Company is pleased that Staff supports a means to allow UNS Electric to achieve that
2 end.

3
4 **Q. Was there anything else from Mr. Becker's pre-filed testimony you wanted to**
5 **address?**

6 **A.** No. UNS Electric appreciates Staff's support of our efforts to acquire a portion of Unit 3
7 and willingness to reach a compromise that would allow for the deferral of non-fuel costs
8 associated with the Plant as I have detailed above.

9
10 **IV. STANDARDS FOR AN ACCOUNTING ORDER.**

11
12 **Q. What do you understand to be the Commission's standard for approval of an**
13 **accounting order similar to what UNS Electric is requesting?**

14 **A.** The most recent case I am aware of involving a request for an accounting order involved
15 Arizona Public Service Company ("APS") and its request to (among other things) defer
16 costs associated with acquiring Southern California Edison Company's ("SCE") share of
17 Units 4 and 5 of the Four Corners Generating Station ("Four Corners 4 and 5"). This
18 request was made in 2010.⁷

19
20 In that Decision, the Commission essentially stated that a variation from the typical
21 ratemaking treatment (approving an accounting order through establishing a regulatory
22 asset to defer costs typically expensed) is appropriate if there are benefits to be obtained
23 from the transaction at issue. In that case, the Commission largely approved APS's
24 request to defer for possible later rate recovery all non-fuel costs of owning, operating
25 and maintaining the acquired interests in each generation plant. The Commission
26 approved APS's request. The Commission found in both cases, based on the

27

⁷ See Decision No. 73130 (April 24, 2012).

1 circumstances, that the benefits to the acquiring SCE's share of Four Corners 4 and 5
2 warranted a variation from the usual ratemaking treatment.⁸ The Commission found that
3 APS's identified benefits for the transaction justified deferral. Those benefits included:
4 (1) that acquiring Units 4 and 5 is the lowest cost option to acquire needed base load
5 generation⁹; (2) preserves an existing interest in reliable low-cost generation¹⁰; (3) allows
6 APS to maintain a diversified portfolio¹¹; and (4) provides for environmental benefits.¹²

7
8 There are other examples of the Commission approving deferral of costs under an
9 accounting order such as Central Arizona Project holding charges.¹³ Previous decisions
10 reflect similar considerations but ultimately depend on the particular circumstances of the
11 request.

12
13 **Q. Does the acquisition of Unit 3 satisfy the standard for approval of an accounting**
14 **order?**

15 **A.** Yes. As noted throughout this testimony, there are significant benefits to both the
16 Company and its customers that fully justify the issuance of an accounting order as
17 outlined in Staff's testimony.

18
19
20
21
22
23
24
25 ⁸ See Decision No. 73130 at 36.

26 ⁹ Id at 8-9.

27 ¹⁰ Id. at 9-10.

¹¹ Id. at 10-11.

¹² Id. at 11-12.

¹³ *In re Agua Fria Water Division of Citizens Comm. Co.*, Decision No. 58750 (August 31, 1994).

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V. CONCLUSION.

Q. Do you have any concluding remarks?

A. An accounting order will help facilitate UNS Electric's purchase of a strategically located, reasonably priced, natural gas generating facility. The purchase of Unit 3 would provide UNS Electric with a stable, efficient generating resource for 40 percent of its long term capacity needs, reducing its reliance on the wholesale market and helping the Company reliably integrate an increasing share of renewable resources into its portfolio.

Additionally, the accounting order itself provides benefits including:

- No bill impact to customers during the deferral period. The deferral treatment of Unit 3 will not result in any immediate change to customer bills since both the costs and benefits of owning Unit 3 will be deferred to the Company's next rate case.
- No material impact to UNS Electric's financial condition during the deferral period. The accounting deferral allows the Company to align the costs and benefits of Unit 3 without materially impacting UNS Electric's financial condition or credit rating.
- No determination of prudence by the Commission, Staff or RUCO of the Company's purchase of Unit 3. The Commission will be able to review the purchase of Unit 3, and all related costs and benefits, when the Company files its next rate case.

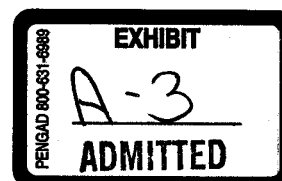
Q. Does that conclude your testimony?

A. Yes, it does.

UNS Electric, Inc.
Gila River Power Plant Unit 3 Acquisition Accounting Order
Plan of Administration

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1. GENERAL DESCRIPTION

This document describes the plan of administration for the Gila River Power Plant Unit 3 Acquisition Deferred Accounting Order ("Order") as approved by the Arizona Corporation Commission ("ACC") in Decision No. XXXXX (date) for UNS Electric, Inc. ("UNSE" or "Company").

The Order authorizes the deferral of certain Non-fuel costs (collectively defined as "Deferred Costs" in Section 3), and short-term fuel and purchased power savings (collectively defined as "Deferred Savings" in Section 4) associated with the Company's purchase of a 25% interest in Unit 3 at the Gila River Power Plant ("Gila 3"). These Deferred Costs and Deferred Savings will be evaluated during the Company's next rate case. During this interim period between January 1, 2015, and the earlier of April 30, 2016, or the date new rates go into effect for UNSE (the "Deferral Period"), the cumulative Deferred Cost will not exceed the lower of \$10.5 million or the cumulative Deferred Savings as of April 30, 2016. For purposes of calculating the Purchased Power and Fuel Adjustment Clause ("PPFAC"), Deferred Savings will continue to accrue until new rates become effective; however, cumulative Deferred Costs will not increase after April 30, 2016, regardless of Deferred Savings applicable to periods after April 30, 2016.

2. DEFINITIONS

Accounting Order – A rate-making mechanism used by a regulatory authority that allows the deferral of costs and/or savings by a regulated utility for possible future recovery or credit.

Carrying Costs – Costs accrued at a 5.0000% annual rate on the company's Net Book Investment of Gila 3 including the Company's pro rata share of any directly related associated Material and Supplies.

Fuel and Purchased Power Costs – The costs recorded for the fuel and purchased power used by UNSE to serve both Native Load Energy Sales and Wholesale Sales. Wheeling costs are included in Fuel and Purchased Power costs.

Native Load Energy Sales – Retail Native Load Energy Sales and Wholesale Native Load Energy Sales in the UNSE control area for which UNSE has a generation service obligation.

Net Book Investment – The cost of the Company's investment in its share of the plant, reduced by total depreciation and amortization recorded, plus the Company's pro-rata share of any directly related Materials and Supplies.

Off-Peak Power – Power for delivery Monday through Saturday from hour ending 2300 through hour ending 0600 Pacific Prevailing Time, and hour ending 0100 through hour ending 2400 Pacific Prevailing Time on Sunday and North American Electric Reliability Corporation ("NERC") holidays.

On-Peak Power – Power for delivery Monday through Saturday, excluding NERC Holidays, from hour ending 0700 through hour ending 2200, Pacific Prevailing Time.

Off System Sales - Energy sales other than those to directly meet the Company's native load obligations.

Palo Verde Hub – Palo Verde , also known as "PV" is a major cumulative western market trading hub that includes the Palo Verde substation and the Hassayampa substation.

PPFAC – The Purchased Power and Fuel Adjustment Clause ("PPFAC") initially approved by the Commission in Decision No. 70360, and amended in Decision No. 74235. The PPFAC rate tracks the changes in the cost of obtaining power supplies based upon a historical 12-month rolling average of fuel, purchased power and purchased transmission costs as defined in the PPFAC Plan of Administration and is adjusted monthly.

Short-term Sales – Wholesale sales with a duration of less than one year made to non-Native Load customers for the purpose of optimizing the UNSE system, using UNSE-owned or contracted generation and purchased power.

Wholesale Sales – Sales to non-retail customers.

3. ALLOWABLE DEFERRED COSTS

The Deferred Costs as defined below, associated with owning, operating and maintaining UNSE's 25% interest in Gila 3 will be deferred as a regulatory asset during the Deferral Period, subject to the lower of \$10.5 million or the cumulative Deferred Savings as of April 30, 2016. The costs eligible for deferral are limited to:

1. Depreciation and Amortization costs.
2. Property taxes.
3. O&M expenses.
4. Carrying Costs on Net Book Investment, both as defined above.

4. ALLOWABLE DEFERRED SAVINGS

The Deferred Savings associated with owning and operating UNSE's 25% interest in Gila 3 will be deferred as a regulatory liability, and will accrue during the period beginning January 1, 2015 and ending upon the date new rates go into effect following UNSE's next rate case. The Deferred Savings are limited to:

1. Energy costs based on published PV (the major wholesale power hub for UNSE's service territory) day-ahead-market prices from the Intercontinental Exchange ("ICE") for On-Peak and Off-Peak power, less actual fuel costs, plus
2. Avoided long term capacity procurement costs at \$1.52 per kW/month as approved in Accounting Order Decision No. [XXXXXXX], and offset by
3. Short term wholesale sales revenues associated with Gila 3.

Deferred Savings are considered "allowable costs" for purposes of calculating UNSE's PPFAC but will not be included as part of the PPFAC bank for purposes of calculating accrued interest.

5. COMPLIANCE REPORTS

UNSE shall provide monthly reports to the Commission's Docket Control and to the Residential Utility Consumer Office detailing all calculations related to allowable cost included in the PPFAC. Monthly reports will be due within 45 days of the end of a reporting period. The information contained in the Compliance Reports will consist of the following schedules:

- Schedule A: Allowable Deferred Costs
- Schedule B: Allowable Deferred Savings
- Schedule C: Any Wholesale Sales which are 1 year or greater in duration. This schedule shall describe the dates, the number of MW's sold, type of service (firm, non-firm, etc.) and ancillary services (if any), type of sale (on peak, around the clock, etc.),

UNSE Electric, Inc.
Gila River Acquisition Deferred Accounting Order
Schedule A - Deferred Costs

Line No.	Allowable Components	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16
1	Purchased Price	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2	Material and Supplies ¹	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
3	Accumulated Depreciation	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
4	Total Rate Base (Line 1 + 2 + 3)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
5	Carrying Costs (Line 4 * 0.05 / 12) ²	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
6	Depreciation and Amortization	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
7	Property Tax	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
8	Operating and Maintenance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
9	Deferred Costs (Line 5 + 6 + 7 + 8)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
9	Total Deferred Costs ³	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Notes:

- UNSE share of material and supplies attributable to Gila River
- Carrying Costs are Calculated at 5% per Decision XXXXX
- Total Cumulative Deferred Costs will not exceed the lower of \$10.5 million or the cumulative Deferred Savings as of April 30, 2016.

UNS Electric, Inc.
Gila River Acquisition Deferred Accounting Order
Schedule B - Deferred Savings

Line No.	Allowable Components	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16
1	Total Gila River Generation for UNSE, MWh (Line 4 + 11)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2	Gila River Retail On-Peak, MWh	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3	Gila River Retail Off-Peak, MWh	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
4	Total Gila River Retail, GWh (Line 2 + 3)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
5	Palo Verde ICE On-Peak, \$/MWh (1)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
6	Palo Verde ICE Off-Peak, \$/MWh (1)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
7	Market Value of Replacement Energy On-Peak (Line 2 * 5)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
8	Market Value of Replacement Energy Off-Peak (Line 3 * 6)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
9	Market Value of Replacement Energy (Line 7 + 8)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
10	Avg. Market Value of Replacement Energy, \$/MWh (Line 9 / 4)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
11	Wholesale Sales from Gila River, MWh (Line 1 - 4)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
12	Wholesale Sales Revenues from Gila River (Line 11 * 13)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
13	Avg. Wholesale Sales from Gila River, \$/MWh	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
14	Gila River Fuel Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
15	Gila River Fuel Burn, GWh	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
16	Gila River Fuel Expense, \$/MWh (Line 14 / 1)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
17	Gila River Fuel Expense, \$/MWh (Line 14 / 15)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
18	Market Value of Replacement Energy (Line 9)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
19	Wholesale Sales Revenues from Gila River (Line 12)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
20	Avoided Capacity Savings (2)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
21	Less Gila River Fuel Expenses (Line 14)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
22	Total Deferred Savings (Line 18 + 19 + 20 + 21)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
23	Cumulative Deferred Savings	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Notes:
1 To be based on market prices from the Intercontinental Exchange (ICE)
2 Capacity Purchases are \$1.52 per kW/month per Decision XXXX

UNS Electric, Inc.
Gila River Acquisition Deferred Accounting Order
Schedule C - Long-Term Wholesale Sales by UNS Electric, Inc.

☐ UNS Electric *did not* enter into any wholesale sales contracts with a term of at least 12 months

☐ UNS Electric entered into the following wholesale sales contract(s) with a term of at least 12 months. (1)

Line No.	Counterparty	Start Date	End Date	Monthly Sales (MWh)	Firm or Non-Firm	On-Peak, Off-Peak, Around-the Clock	Ancillary Services (if any)
----------	--------------	------------	----------	------------------------	------------------	--	--------------------------------

1

Notes:

1 Confidential contract terms will be made available to Staff and RUCO pursuant to the terms of the protective agreement.



UNS ELECTRIC, INC.
DOCKET NO. E-04204A-13-0476

DIRECT TESTIMONY
OF
JEFFREY M. MICHLIK

ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE

DECEMBER 5, 2014

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EXECUTIVE SUMMARY

On December 31, 2013, UNS Electric, Inc. ("UNS or Company") filed an application with the Arizona Corporation Commission ("Commission") requesting an accounting order authorizing the deferral for future recovery of non-fuel costs associated with the Company's prospective purchase of up to a 25 percent interest in Unit 3 at the Gila River Power Plant ("Gila Unit 3"). These costs would include depreciation and amortization costs, property taxes, O&M expenses and carrying costs associated with owning, operating and maintaining the Plant.

Since that time Staff and UNS have agreed to changes in UNS' accounting order.

The direct testimony of Jeffrey M. Michlik addresses UNS' request for an accounting order.

RUCO recommends the revised accounting order, as agreed to by UNS and Staff be approved, subject to the addition of the following recommended language:

IT IS FURTHER ORDERED that in the event a settlement agreement is reached in UNS Electric, Inc.'s next rate case, any changes to the deferral order including changes to the carrying costs shall be thoroughly explained in the settlement agreement.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Jeffrey M. Michlik. I am a Public Utilities Analyst V employed by the Arizona Residential Utility Consumer Office ("RUCO"). My business address is 1110 West Washington Street, Suite 220, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst V.

A. In my capacity as a Public Utilities Analyst V, I analyze and examine accounting, financial, statistical and other information and prepare reports based on my analyses that present RUCO's recommendations to the Arizona Corporation Commission ("Commission") on utility revenue requirements, rate design and other matters. I also provide expert testimony on these same issues.

Q. Please describe your educational background and professional experience.

A. In 2000, I graduated from Idaho State University, receiving a Bachelor of Business Administration Degree in Accounting and Finance, and I am a Certified Public Accountant with the Arizona State Board of Accountancy. I have attended the National Association of Regulatory Utility Commissioners' ("NARUC") Utility Rate School, which presents for study

1 and review general regulatory and business issues. I have also attended
2 various other NARUC sponsored events.

3
4 I joined RUCO as a Public Utilities Analyst V in September of 2013. Prior to
5 my employment with RUCO, I worked for the Arizona Corporation
6 Commission in the Utilities Division as a Public Utilities Analyst for a little
7 over seven years. Prior to employment with the Commission, I worked one
8 year in public accounting as a Senior Auditor, and four years for the Arizona
9 Office of the Auditor General as a Staff Auditor.

10
11 **Q. What is the scope of your testimony in this case?**

12 **A.** I am presenting RUCO's analysis and recommendations on UNS' proposed
13 accounting to defer for future recovery of specific non-fuel costs related to
14 its planned 25 percent acquisition/ownership stake in Unit 3 at the Gila River
15 Power Plant ("Gila Unit 3"), including: (i) depreciation and amortization
16 costs, (ii) property taxes, (iii) O&M expenses, (iv) a carrying cost on the
17 Plant investment ("carrying costs"), and (v) any other non-fuel Plant costs.

18
19 **II. UNS CORPORATE STRUCTURE**

20 **Q. Can you provide some more background on UNS' corporate**
21 **structure?**

22 **A.** Yes. UNS Energy is a subsidiary of Fortis Inc., the largest investor-owned
23 electric and gas distribution utility in Canada. UNS Energy is based in

1 Tucson, Arizona and is the parent company of both Tucson Electric Power
2 (TEP) and UniSource Energy Services (UES). TEP serves more than
3 414,000 customers in and around Tucson, while UES provides natural gas
4 and electric service to about 243,000 customers in northern and southern
5 Arizona. Electric service is provided through a UES subsidiary called UNS
6 Electric, Inc., while natural gas service is provided through a subsidiary
7 called UNS Gas, Inc.

8
9 **III. UNS' REQUEST FOR AN ACCOUNTING ORDER**

10 **Q. Please provide some more background on the proposed purchase of**
11 **Gila Unit 3.**

12 **A.** Based on the Company's application dated December 23, 2013 TEP and
13 UNS entered into an agreement to purchase Gila Unit 3 for \$219 million.
14 TEP would acquire a 75 percent or a \$164.25 million share, and UNS would
15 acquire a 25 percent or \$54.75 million share in Gila Unit 3.

16
17 **Q. Has TEP asked for an accounting order to defer its 75 percent share**
18 **or approximate \$164 million share in Gila Unit 3?**

19 **A.** No.
20

1 **Q. Why?**

2 A. Through conversation and a data response from the Company, TEP due
3 to its greater size is able to absorb the costs without asking for a deferral,
4 and will ask for recovery in its next rate case, under traditional ratemaking.
5

6 **Q. Does TEP or UNS need Commission approval to purchase Gila Unit**
7 **3?**

8 A. No.
9

10 **Q. Has the UNS already received regulatory approval for the purchase**
11 **of Gila Unit 3 from Federal Regulatory Energy Commission**
12 **("FERC")?**

13 A. Yes.
14

15 **Q. When does UNS expect to purchase Gila Unit 3?**

16 A. December 10, 2014.
17

18 **Q. Should the Commission approve an accounting order?**

19 A. Yes. The Commission can deny the Company an accounting order, but
20 RUCO believes that would be unwise. In simple terms, under traditional
21 ratemaking the Company acquires or builds plant between rate cases.
22 Once the normal prudence issues and used and useful issues are
23 reviewed and authorized in the context of a general rate case, the

1 Company's plant is normally included in rate base, and the Company
2 receives a return of and on its plant investments. In this case, due to the
3 **significant** investment in plant for UNS' share, the Company is asking
4 that the timing be changed and the costs that would normally be forgone
5 until the plant is included in rate base under traditional ratemaking in the
6 next rate case be deferred for future recovery.

7
8 UNS' is asking for 25 percent of UNS' share of the acquisition to be
9 deferred, while TEP is **not** asking for the 75 percent related to TEP's share
10 of the acquisition to be deferred. As RUCO represents ratepayers
11 statewide, RUCO is pleased that the Company is asking for traditional rate
12 making treatment for TEP's customers. Based on RUCO's analysis, RUCO
13 agrees with the Company that the acquisition of Gila Unit 3 will have a
14 significant impact on UNS's financial statements. If an accounting order is
15 not approved, this could affect UNS' financial viability in the future.

16
17 **Q. What is the purpose of an accounting order?**

18 **A.** An accounting order is a rate-making mechanism that provides regulated
19 utilities the ability to defer costs that would otherwise be expensed under
20 generally accepted accounting principles. It also permits alternative
21 accounting treatment for capital and other costs as permitted under the
22 FERC Uniform System of Accounts ("USoA"). In other words, UNS cannot
23 request retroactive recovery of these costs. However, the Commission can

1 authorize UNS to defer these costs by approving the accounting order and
2 consider recovery of these costs in a future rate case. The granting of an
3 accounting order is not tacit approval of the costs but has traditionally
4 resulted in Commission approval of the costs in question.

5
6 **Q. How are the costs authorized for deferral by an accounting order**
7 **tracked?**

8 A. The deferrals are recorded in a deferral account to maintain a running
9 balance. Then, in a future rate case, the Commission decides whether to
10 include none, some, or all of the costs in rates.

11
12 **Q. Is the purpose of an accounting order to guarantee recovery of**
13 **previously incurred and not yet recovered costs or to guarantee**
14 **recovery of authorized deferrals?**

15 A. No. In the case of an accounting order for cost deferral, the purpose is **to**
16 ***preserve the opportunity*** to have recovery of certain costs ***considered in***
17 ***the future***. The Commission should not predetermine the recoverability of
18 costs; rather it should allow for post-incurrence review for reasonableness,
19 appropriateness and prudence. This would be determined in the Company's
20 next rate case filing.

1 **Q. Did the Company provide language that it desires to include in its**
2 **accounting order, and is this consistent with the above discussion?**

3 A. Yes. For convenience, the Company's proposed accounting order
4 language is reproduced here.

5
6 IT IS THEREFORE ORDERED that UNS Electric, Inc. is authorized to defer
7 for possible later recovery through rates, all non-fuel costs (as defined
8 herein) of owning, operating and maintaining up to an acquired 25 percent
9 interest in Gila River Power Plant Unit 3 and associated facilities. Nothing
10 in this Decision shall be construed in any way to limit this Commission's
11 authority to review the entirety of the acquisition and to make any
12 disallowances thereof due to imprudence, errors or inappropriate
13 application of the requirements of this Decision.

14
15 IT IS FURTHER ORDERED that UNS Electric, Inc. shall reduce the
16 deferrals by any fuel and purchased power savings and off-system sales
17 not otherwise reflected in its Purchased Power and Fuel Adjustment Clause.

18
19 IT IS FURTHER ORDERED that the accumulated deferred balance
20 associated with all amounts deferred pursuant to this Decision will be
21 included in the cost of service for rate-making purposes in UNS Electric,
22 Inc.'s next general rate case. Nothing in this Decision shall be construed to
23 limit this Commission's authority to review such balance and to make

1 disallowances thereof due to imprudence, errors or inappropriate allocation
2 of the requirements of this Decision.

3
4 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare and retain
5 accounting records sufficient to permit detailed review, in a rate proceeding,
6 of all deferred costs and cost benefits as authorized herein.

7
8 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare a separate
9 detailed report of all costs deferred under this authorization and shall
10 include that report as an integral component of each of its general rate
11 applications in which requests recovery of those deferred costs.

12
13 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file an annual
14 status report for each preceding calendar year, of all matters related to the
15 deferrals, and the cumulative costs thereof every April 1 with Docket
16 Control, as a compliance item in this Docket, with the first such report due
17 not later than April 1, 2015.¹

18
19

¹ See pages 7 through 8 of the Company's initial accounting order request dated December 31, 2013.

1 **Q. Since the advent of the Company's initial accounting order request,**
2 **and Staff's direct testimony have Staff and the Company agreed to any**
3 **changes in the language of the accounting order?**

4 A. Yes.

5
6 **Q. Did Staff identify any additional conditions and clarifications that**
7 **should be reflected in the accounting order?**

8 A. Yes. Staff's proposed accounting order language is reproduced here.

9 1. That costs subject to deferral be limited to:

10 a. depreciation and amortization costs,

11 b. property taxes,

12 c. O&M expenses, and

13 d. carrying costs² associated with owning, operating, and
14 maintaining the plant

15 2. that certain benefits of owning the plant shall also be deferred,

16 a. the avoided cost of capacity should be based on the readily
17 available market value as proposed by the Company,

18 b. that that the energy savings related to power production at Gila 3
19 should be calculated based on the difference between the non-
20 firm market price of energy and the fuel cost,

21 c. that the net benefit of any wholesale value arising from the
22 ownership of Gila 3 should also be deferred,

² Calculated at 5.0000 percent.

3. that the value of deferred benefits shall be subject to inclusion in the Company's ongoing PPFAC calculations,
4. that the deferred costs and deferred benefits shall be evaluated in a future rate proceeding,
5. that the ratepayers be held harmless for any deferred costs in excess of deferred benefits,
6. that the amount of any deferred benefits in excess of deferred costs shall be used as a reduction to the running balance in the PPFAC arising from non - Gila 3 activity,
7. that any authorizations to defer costs shall be limited to \$10.5 million,
8. that any authorizations to defer costs shall expire no later than May 1, 2016. Any expense incurred after April 30, 2016 would not be eligible for deferral.
9. that no prudence determination be made at this time and that the prudence of the purchase of Gila 3 will be determined in a future rate proceeding,
10. that there shall be no carrying costs on any under-recovered PPFAC balance resulting from the purchase of Gila 3,
11. that the Company file a plan of administration within 30 days of the filing of this testimony for consideration and inclusion in the final decision.

1 **Q. Does RUCO disagree with any of the additional language Staff is**
2 **recommending and the Company has accepted?**

3 **A. No.**
4

5 **Q. Does RUCO have any recommendations regarding language that**
6 **should be included in the accounting order?**

7 **A. Yes, as will be discussed later.**
8

9 **IV. RUCO'S ANALYSIS**

10 **Q. What Criteria has RUCO used to analyze the Company proposed**
11 **accounting order?**

12 **A. RUCO considered 1) the financial impact of the transaction, and 2) the prior**
13 **APS accounting order for comparison purposes, and by examining the**
14 **following factors: Environmental Risk, Decommissioning Costs, the**
15 **Purchase Power and Fuel Adjustment Clause, the Acquisition Premium or**
16 **Discount, the Deferral Time Period and Limit on the Deferral Amount, the**
17 **Added Benefits for Ratepayers, and the Carrying Costs.**
18

19 **1. Financial Impact of the transaction**

20 **Q. Has UNS provided any information to assist in an assessment of the**
21 **impact the proposed accounting order would have on its financial**
22 **statements?**

23 **A. Yes. However, some of this information is confidential. But, based on page**

1 5 of the Company's accounting order request filing, the Company stated
2 that purchase price would represent approximately 28 percent of the
3 Company's rate base approved in its last rate case.

4
5 **Q. Based on Commission Decision No. 74235, dated September 30, 2013,**
6 **which was the result of a settlement agreement, and utilized a test year**
7 **ending December 31, 2012, were you able to extrapolate additional**
8 **financial information?**

9 **A.** Yes. The Company stated in a data response that the "Company updated
10 its estimated Unit 3 non-fuel costs for the period January 1, 2015 through
11 April 30, 2016 using a carrying cost of 5.0000% which totaled approximately
12 \$10.5 million."

13
14 Based on total revenues authorized in the last rate case of \$174,637,342,
15 the percent of revenues would be approximately 6 percent (i.e.
16 \$10,500,000/\$174,637,342).

17
18 Similarly based on total operating income authorized in that case of
19 \$28,175,500, the percentage of operating income effected by the
20 transaction would be approximately 37 percent (i.e.
21 \$10,500,000/\$28,175,500).

1 **Q. Based on the financial metrics of the proposed transaction is RUCO**
2 **in agreement that the investment in Gila Unit 3 is financially**
3 **significant?**

4 **A. Yes.**
5

6 **2. The Prior Arizona Public Service ("APS") Accounting Order**

7 **Q. Are you familiar with the one approved in Commission Decision No.**
8 **73130 dated April 24, 2012?**

9 **A. Yes. I was Staff's witness at the time and presented testimony in that**
10 **case.**
11

12 **Q. Please provide some background on Decision No. 73130.**

13 **A. In that case there were two issues 1) APS needed authorization to purchase**
14 **Southern California Edison ("SCE") interest in the Four Corners Power Plant**
15 **(specifically units 4 and 5) which consisted of five coal generating units and**
16 **2) an accounting order to defer some of the purchase and operation costs.**
17 **Ultimately, Decision No. 73130 approved both of APS' requests. As already**
18 **stated UNS does not need Commission approval to purchase Gila Unit 3,**
19 **so I will focus the rest of the discussion on the second issue which is the**
20 **accounting order.**
21

1 **Q. Are the deferral items³ that UNS is requesting to defer similar if not the**
2 **same to the deferral items approved in the APS case?**

3 **A. Yes, and UNS has acknowledged it modeled its accounting order language**
4 **after the language used in Decision No. 73130.⁴**

5
6 **Environmental Risk**

7 **Q. Environmental risks have become an issue not just for Utility**
8 **Companies, but also for ratepayers in which the Utility Companies**
9 **pass through these costs to ratepayers in the form of surcharges.⁵**
10 **Please discuss any Environmental risks associated with UNS'**
11 **purchase of Gila Unit 3.**

12 **A. Based on a RUCO data request sent to UNS, the Company identified the**
13 **following two areas of concern:**

14
15 "There are two pending regulations we are aware of that may be applicable
16 to Gila 3:

17
18 1) The proposed New Source Performance Standard for carbon dioxide
19 emitted from existing power plants ("CO2 NSPS"). Gila 3, as a natural

³ Depreciation and amortization costs; property taxes; O&M expenses; carrying costs associated with owning, operating and maintain the plant, and other non-fuel plant costs.

⁴ See page 7, line 15 of the Company's application.

⁵ See APS' Federal Environmental Improvement Surcharge from their website, which recovers a portion of the cost of investments and expenses for environmental improvements at their generating facilities in order to comply to environmental standards mandated by federal law and regulations.

1 gas combined cycle plant emits carbon dioxide and will be subject to the
2 regulation. UNS Electric anticipates that impacts on Gila 3 operations
3 will be minimal as the proposed rule primarily targets coal fired sources
4 of carbon dioxide. Given the fact that the rule will not be finalized until
5 mid-2015, the impact of the proposed regulation is unknown at this time.
6

7 2) EPA is currently considering revising the National Ambient Air Quality
8 Standard for Ozone ("Ozone NAAQS"). If the standard is revised lower,
9 the State Implementation Plan may require reduction of nitrogen oxides
10 ("NOx") in non-attainment areas. Gila 3 is a source of NOx (a precursor
11 to ozone), however as a currently permitted source, UNS Electric does
12 not expect that any reductions will be necessary at Gila 3."
13

14 Further, "Cost of compliance with the CO2 NSPS and/or the Ozone NAAQS
15 is unknown at this time but UNS Electric does not anticipate any significant
16 cost or material operational changes associated with the implementation of
17 these regulations."
18

19 Based on the responses the Company indicates that any Environmental
20 risks at this time would be minimal.
21

1 Contrasted to the APS case, in which APS knew about several pending
2 EPA regulation and had actual estimated compliance costs in excess of
3 \$660 million.⁶

4
5 All other things being equal the less Environmental risk the less potential
6 costs that will be passed onto ratepayers, which is a benefit to ratepayers.

7
8 **Decommissioning Costs**

9 **Q. Please discuss the issue of decommissioning costs?**

10 **A.** Based on a RUCO data request sent to the UNS, the Company responded
11 as follows:

12
13 "Yes, the Company expects to incur future decommissioning costs for Gila
14 3. The Company has not prepared a decommissioning study for Gila 3, but
15 expects the costs to be similar to the Luna Energy Facility owned by TEP."

16
17 Both APS and UNS have decommission costs associated with their
18 acquisition purchases. These decommissioning costs will add to the long-
19 term cost of the asset, but the Company is not asking to defer these costs
20 in the accounting order.

21
22

⁶ See page 3, line 12 of Decision No. 73130.

Purchase Power and Fuel Adjustment Clause ("PPFAC")

Q. Please explain what the PPFAC is and how it works?

A. In order to reduce UNS' volatility in fuel and power costs between rate cases the Commission has authorized the use of a PPFAC.

The Company in a data request response to RUCO stated that "UNS uses a historical 12 month rolling average of actual fuel, purchased power and wheeling costs less revenues from short-term wholesale sales to set a PPFAC rate. The PPFAC rate is adjusted on a monthly basis."

Q. How will the purchase of Gila Unit 3 effect the Company's PPFAC?

A. The Company in a data request response to RUCO stated that "by acquiring an interest in Unit 3, UNS Electric will meet a portion of its retail load with output from the plant and reduce its reliance on the market for purchased energy and capacity. As a result, the costs recovered through generation, net of revenues from short-term wholesale sales, is expected to be less than the costs that otherwise would have been incurred to purchase energy and capacity."

It appears from the Company's analysis that by purchasing Gila Unit 3, ratepayers will benefit through the PPFAC.

1 **Q. Originally, UNS wanted to run any cost savings immediately through**
2 **the PPFAC, but have now agreed with Staff to defer this savings, in**
3 **order to stabilize customers' bills in the future. Is this your**
4 **understanding?**

5 **A. Yes, and RUCO is not opposed to this.**
6

7 **Acquisition Premium or Discount**

8 **Q. Please define what is meant by an acquisition premium or discount?**

9 **A. A premium or discount is calculated by taking the purchase price less the**
10 **net book value (asset – accumulated depreciation). If the value is negative**
11 **a discount results and if the value is positive a premium results.**
12

13 **Q. What is the amount of the acquisition premium or discount in this**
14 **case?**

15 **A. UNS estimates a \$50.4 million *discount* of which \$12.6 million relates to**
16 **UNS' purchase.**
17

18 **Q. In the APS case was there an acquisition premium or discount?**

19 **A. In the APS case there was an acquisition *premium* of approximately \$252**
20 **million, in other words the Company paid more than the assets were worth.⁷**
21

⁷ See the Surrebuttal Testimony of RUCO witness Robert B. Mease, page 3, line 17 in Docket No. E-01345A-11-0224.

1 All other things being equal ratepayers benefit from an acquisition discount
2 as in this case as opposed to acquisition premium.
3

4 **Deferral Time Period and Limit on Deferral Amount**

5 **Q. To your knowledge has Staff and the Company agreed to a deferral**
6 **time period which would include the months of January 1, 2015**
7 **through April 30, 2016, and limit the amount of the deferral to \$10.5**
8 **million dollars?**

9 **A. Yes.**
10

11 **Q. Was there a limit on the amount that could be deferred in the APS**
12 **case?**

13 **A. No.**

14 Ratepayers benefit from caps on both the deferral time period and
15 amounts that can be deferred.
16

17 **Added Benefits for Ratepayers**

18 **Q. As mentioned earlier in Staff's recommendations, Staff has included**
19 **additional provisions to protect ratepayers, please comment.**

20 **A. Condition 5, states that ratepayers shall be held harmless for any deferred**
21 **costs in excess of deferred benefits, and condition 10, states that there shall**
22 **be no carrying costs on any under-recovery of the PPFAC balance resulting**
23 **from the purchase of Gila 3.**

1 **Carrying Cost**

2 **Q. Has the Company asked for a carrying cost to be applied to the**
3 **deferral balance?**

4 A. Yes, originally the Company asked for an average cost of debt of 5.97
5 percent, but has agreed with Staff and has lowered this cost to 5.0000
6 percent.

7
8 **Q. Has RUCO confirmed this percentage?**

9 A. Yes.
10

11 **Q. In the APS case did the Company request a carrying costs on the**
12 **deferral?**

13 A. Yes the Company asked not only for a debt component, but also an equity
14 component of 11.00 percent.⁸
15

16 **Q. What was the final determination in Decision No. 73130?**

17 A. The Commission Order allowed for the documented debt costs of acquiring
18 SCE's interest in units 4 and 5.
19

20 Obviously the lower the carrying costs the greater the benefits to
21 ratepayers.

⁸ The final determination in Decision No. 73130 allowed for the documented debt costs of acquiring SCE's interest units 4 and 5.

1 Q. What is RUCO's recommendation regarding the carrying costs of
2 5.0000 percent requested by the Company in this case?

3 A. RUCO does not oppose a carrying cost of 5.0000 percent.
4

5 Q. But wait, isn't this contrary to your position in the APS case?

6 A. In light of the stark differences between the APS case and this case, and
7 the superior benefits that will be passed onto ratepayers, as will be
8 discussed in the conclusion section, RUCO believes a 5.0000 percent
9 carrying cost to be appropriate in this case, and in this case only. ***Stated***
10 ***another way this may or may not be RUCO's position to include a***
11 ***carrying cost in the Company's next accounting order, or in any other***
12 ***utility companies accounting order in the future (emphasis added).***
13

14 V. RUCO's ACCOUNTING ORDER LANGUAGE RECOMENDATION

15 Q. Is there any language that RUCO would like to see incorporated into
16 the accounting order?

17 A. Yes. RUCO would like to incorporate the following language into the
18 accounting order:
19

20 IT IS FURTHER ORDERED that in the event a settlement agreement is
21 reached in UNS Electric, Inc.'s next rate case, any changes to the deferral
22 order including changes to the carrying costs shall be thoroughly explained
23 in the settlement agreement.

1 **Q. Why does RUCO consider this additional language important?**

2 A. RUCO, Staff, and APS just finished a hearing involving what the carrying
3 costs and deferral amount on the Four Corners deferral should be.⁹ In order,
4 to avoid litigation, and a lengthy time consuming hearing, RUCO
5 recommends the additional paragraph as recommended be inserted into
6 the accounting order.

7
8 **VI. OTHER ISSUES**

9 **Q. Has the Company put forth a draft Plan of Administration?**

10 A. Yes, as recommended by Staff.

11
12 **VII. CONCLUSION**

13 **Q. Please summarize why RUCO believes this accounting order should**
14 **be approved with the additional language added to the accounting**
15 **order.**

16 A. In summary RUCO believes the Accounting Order should be approved for
17 the following reasons:

- 18 a. UNS' is asking for 25 percent of UNS' share of the acquisition to be
19 deferred, while TEP is *not* asking for the 75 percent related to TEP's
20 share of the acquisition to be deferred. As RUCO represents

⁹ See Docket No. E-01345A-11-0224. In addition, there still has not been a Commission Decision on what the carrying cost and amount should be in that case.

1 ratepayers statewide, RUCO is pleased that the Company is asking
2 for traditional rate making treatment for TEP's customers.

3 b. Based on RUCO's analysis, RUCO agrees with the Company that
4 the acquisition of Gila Unit 3 will have a significant impact on UNS's
5 financial statements. If an accounting order is not approved, this
6 could affect UNS' financial viability in the future.

7 c. The environmental risks are less for a combined cycle natural gas-
8 fired unit than a coal fired unit, and the lower environmental risks will
9 benefit both UNS and its ratepayers.

10 d. UNS is not requesting deferral of decommissioning costs.

11 e. It is expected that ratepayers will benefit through UNS' PPFAC.

12 f. The transaction will result in an acquisition discount, which benefits
13 to both UNS and its ratepayers.

14 g. There is a deferral time period and limitation on the amount that can
15 be deferred.

16 h. Rate payers shall be held harmless for any deferred costs in excess
17 of deferred benefits, and there shall be no carrying costs on any
18 under-recovered PPFAC balance resulting from the purchase of Gila
19 Unit 3.

20 i. Although RUCO generally does not approve of carrying costs, RUCO
21 believes a carrying cost of 5.0000 percent is reasonable **in this case**
22 **and this case only** for the reasons cited in a. through h.
23

1 **Q. Does this conclude your direct testimony?**

2 **A. Yes.**

3



BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

IN THE MATTER OF THE APPLICATION OF)
UNS ELECTRIC, INC. FOR APPROVAL OF AN)
ACCOUNTING ORDER IN CONNECTION)
WITH THE ACQUISITION OF UP TO A 25%)
INTEREST IN GILA RIVER POWER PLANT)
UNIT 3.)

DOCKET NO. E-04204A-13-0476

DIRECT
TESTIMONY
OF
GERALD BECKER
EXECUTIVE CONSULTANT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

OCTOBER 28, 2014

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**EXECUTIVE SUMMARY
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-13-0476**

On December 31, 2013, UNS Electric, Inc. ("UNS" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to defer, for future recovery, non-fuel costs associated with the Company's prospective purchase of a 25% interest in Unit 3 at the Gila River Power Plant ("Gila 3") to supplant power that is presently purchased on the open market. Unit 3 has a capacity of 550 megawatts and costs \$219 million of which Tucson Electric Power ("TEP") would purchase 75 percent and UNS would purchase 25 percent. While UNS is requesting an accounting order related to this planned purchase, TEP is not. The costs subject to deferral would include depreciation and amortization costs, property taxes, O&M expenses, carrying costs associated with owning, operating, and maintaining the plant, and other non-fuel Plant costs. UNS expects that these costs will be approximately \$9 million by the end of 2015.

The direct testimony of Gerald W. Becker addresses the request for an accounting order.

Staff Recommendations:

Staff recommends denial of the accounting order as reflected in the application. First, the plan as filed by UNS would result in short-term bill reductions but would defer costs for later recovery, resulting in higher rates in a future proceeding. The short-term benefits via reductions would occur to the PPFAC ("Purchased Power and Fuel Adjustment Clause") rate, since only the fuel costs used at the proposed Gila 3 would be included in the current bills, as compared with the total cost of purchased fuel that would be reflected in the PPFAC absent the proposed purchase.

Staff has worked with the Company, and the Company has provided an alternative that Staff recommends. The alternative proposal would forego short-term bill reductions and help to keep customer bills more constant, and essentially defer the short-term savings to a future rate case when deferred savings and deferred costs would be evaluated together.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Gerald Becker. I am an Executive Consultant III employed by the Arizona Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as an Executive Consultant III.

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. In addition, I develop revenue requirements, and prepare written reports, testimonies, and schedules that include Staff recommendations to the Commission. I am also responsible for testifying at formal hearings on these matters.

Q. Please describe your educational background and professional experience.

A. I received a Masters of Business Administration with an emphasis in Accounting from Pace University. I am a Certified Public Accountant and a Certified Internal Auditor.

I have participated in multiple rate, financing and other regulatory proceedings. I attended the National Association of Regulatory Utility Commissioners ("NARUC") Utilities Rate School.

I began employment with the Commission as a utilities regulatory analyst in April 2006. Prior to joining the Commission, I worked as an Auditor at the Department of Economic Security and Department of Revenue in the Taxpayer Assistance Section. Prior to those jobs, I worked for 15 years as an Auditor, Analyst, Financial Analyst, and Budget Manager at United Illuminating, an investor-owned electric company in New Haven, CT.

1 **Q. What is the scope of your testimony in this case?**

2 A. I am presenting Staff's analysis and recommendations regarding UNS Electric, Inc. ("UNS")
3 request for an accounting order. The UNS accounting order would provide for the deferral
4 of depreciation and amortization costs; property taxes; O&M expenses; carrying costs
5 associated with owning, operating, and maintaining the Gila River Power Plant ("Gila 3");
6 and any other non-fuel plant costs associated with Gila 3. UNS expects that these costs will
7 be approximately \$9 million by the end of 2015.

8
9 **II. UNS' REQUEST FOR AN ACCOUNTING ORDER**

10 **Q. Please provide a synopsis of the accounting order requested by UNS.**

11 A. UNS' proposed accounting order would authorize the Company to defer for future recovery:
12 (1) depreciation and amortization costs
13 (2) property taxes,
14 (3) O&M expenses,
15 (4) carrying costs¹ associated with owning, operating, and maintaining the plant, and
16 (5) other non-fuel Plant costs.

17
18 **Q. Did UNS provide language for the accounting order it requests?**

19 A. Yes, the language UNS provided is as follows:

20
21 "IT IS THEREFORE ORDERED that UNS Electric, Inc. is authorized to defer for possible
22 later recovery through rates, all non-fuel costs (as defined herein) of owning, operating and
23 maintaining up to an acquired 25 percent interest in Gila River Power Plant Unit 3 and
24 associated facilities. Nothing in this Decision shall be construed in any way to limit this
25 Commission's authority to review the entirety of the acquisition and to make any
26 disallowances thereof due to imprudence, errors or inappropriate application of the
27 requirements of this Decision.
28
29

¹ UNS originally proposed that carrying costs would be calculated using an average cost of debt of 5.97 percent as approved in Decision No. 74235 for UNS' recent rate case in Docket No. E-04204A-12-0504.

1 IT IS FURTHER ORDERED that UNS Electric, Inc. shall reduce the deferrals by any fuel
2 and purchased power savings and off-system sales not otherwise reflected in its Purchased
3 Power and Fuel Adjustment Clause.
4

5 IT IS FURTHER ORDERED that the accumulated deferred balance associated with all
6 amounts deferred pursuant to this Decision will be included in the cost of service for rate-
7 making purposes in UNS Electric, Inc.'s next general rate case. Nothing in this Decision shall
8 be construed to limit this Commission's authority to review such balance and to make
9 disallowances thereof due to imprudence, errors or inappropriate allocation of the
10 requirements of this Decision.
11

12 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare and retain accounting
13 records sufficient to permit detailed review, in a rate proceeding, of all deferred costs and cost
14 benefits as authorized herein.
15

16 IT IS FURTHER ORDERED that UNS Electric, Inc. shall prepare a separate detailed report
17 of all costs deferred under this authorization and shall include that report as an integral
18 component of each of its general rate applications in which requests recovery of those
19 deferred costs.
20

21 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file an annual status report for
22 each preceding calendar year, of all matters related to the deferrals, and the cumulative costs
23 thereof every April 1 with Docket Control, as a compliance item in this Docket, with the first
24 such report due not later than April 1, 2015.²
25

26 **III. STAFF'S ANALYSIS OF UNS' PROPOSED ACCOUNTING ORDER.**

27 **Q. What is an accounting order?**

28 **A.** An accounting order is a rate-making mechanism occasionally authorized by regulatory
29 authorities in order to provide regulated utilities the ability to defer costs that would
30 otherwise be expensed under generally accepted accounting principles ("GAAP"). Such
31 accounting orders provide for alternative rate-making treatment of capital costs and other
32 costs via creation of regulatory assets and liabilities. Under GAAP, operations and
33 maintenance ("O&M") costs are expensed in the period incurred. Therefore, a utility could
34 not retroactively request recovery of these costs subsequent to closing its books for a prior

² Company application 7 -8

1 period. However, with the appropriate regulatory authority, a utility can defer costs incurred
2 in one period for consideration for recovery in a future period.

3
4 **Q. Describe how the primary effects of accounting orders are recorded under the Federal**
5 **Regulatory Energy Commission ("FERC") Uniform System of Accounts ("USOA")?**

6 A. The primary accounting effect of accounting orders is the creation of regulatory assets and
7 liabilities. Regulatory assets and liabilities are assets and liabilities that result from rate actions
8 of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses,
9 gains or losses that would have been included in the determination of net income in one
10 period under the general requirements of the USOA but for it being probable, due to actions
11 of regulatory authorities, that: 1) such items will be included in a different period(s) for
12 purposes of developing the rates the utility is authorized to charge for its utility services, or 2)
13 in the case of regulatory liabilities, that refunds to the customers, not provided for in other
14 accounts, will be required.

15
16 **Q. What reasons has UNS provided to support its request for an accounting order?**

17 A. UNS provided multiple reasons to support its request. First, UNS estimates that it will incur
18 \$9 million through 2015 in non-fuel expenses. Second, UNS states that the size of the
19 investment (\$55 million) represents approximately 28 percent of the original cost rate base
20 approved in the most recently complete rate case. Third, the Company cites to its recent
21 Integrated Resource Plan ("IRP") and Decision No. 73884 (May 8, 2013) which expressed
22 concern regarding reliance on short-term market purchases. In its application, the Company
23 cites:
24
25
26

1 The cost and availability of such purchases are subject to a wide array of influences that
2 are difficult, if not impossible to predict. For example, if a large number of older coal-
3 fired generating plants are retired in the western region, the availability of such purchases
4 will decline dramatically, and the cost of such purchases will increase significantly.
5 Reliance on short term market purchases in a long-term plan is difficult, if not
6 impossible, to justify. (Decision No. 73884, Page 4)³

7
8 The Company also cites to its own IRP plan:

9
10 UNS Electric will monitor the market for economically attractive plant acquisition
11 opportunities. A low cost, multi-owner acquisition of an existing combined cycle gas
12 fired plant would enable UNS Electric to firm up its longer-term capacity needs while
13 realizing economies of scale through a multi-owner plant configuration (UNSE IRP at
14 Page 13)⁴
15

16 **Q. Does Staff agree with UNS' interpretation of its IRP per Decision No. 73884?**

17 **A.** No. In UNS' IRP plan, acknowledged in Decision No. 73884, Staff concluded that UNS
18 should reduce its reliance on short-term purchases to meet its long term needs, and this could
19 be achieved by pursuing long-term purchased power and not just the purchase of the power
20 plant as the Company seems to represent in its application. Decision No. 73884 did not
21 order UNS to buy a power plant, nor has UNS sent any proposals to secure long term power
22 contracts as an alternative to purchasing Gila 3.
23

24 **Q. Regardless of the above clarification, does Staff recommend approval of changes to**
25 **UNS' PPFAC calculation and the use of certain monies to cover certain costs of Gila**
26 **3?**

27 **A.** Yes. After discussions with the Company, the Company has provided the following revisions
28 to its original proposal:⁵

³ Company application at 2

⁴ *Id.*

⁵ Email dated September 15, 2014 from Jo Smith, Sr. Director, Regulatory Services.

“Deferred Costs and Savings

Non-fuel costs associated with owning, operating and maintaining UNSE’s share of Unit 3 shall be deferred including: O&M expenses, depreciation and amortization expense, property taxes and carrying costs. Carrying costs are to be accrued on the Company’s investment in the Plant at a debt cost of 5.0%, which is less than UNS Electric’s 5.97% cost of debt adopted by the Commission in the Company’s 2013 Rate Order (Decision No.74689).

The cost savings and benefits (purchased power and capacity and short-term wholesale sales margins) resulting from ownership of Unit 3 that would otherwise be passed through the Company’s Purchased Power and Fuel Adjustor Mechanism (“PPFAC”) shall be deferred.

The energy cost savings resulting from ownership of Unit 3 shall be based on the difference between the market value of Unit 3 energy production used to serve retail load, calculated using published on and off-peak market prices from the Intercontinental Exchange (“ICE”) and (ii) the actual fuel costs for Unit 3 allocated to retail load.

The avoided cost of capacity purchases shall be \$1.52 per kW/month, which is based on 3rd party quotes for 2015 demand (capacity) options, which is approximately \$2.5 million on an annual basis.

The margin from short-term wholesale sales shall be based on revenues from short-term wholesale sales less the actual fuel costs for Unit 3 allocated to wholesale sales.

Reductions to UNS Electric’s purchased energy and capacity costs, and the increases in the margin on short-term wholesale sales, resulting from the ownership of Unit 3, shall be calculated monthly.

The amount of these deferred cost savings recovered through UNSE’s PPFAC shall not be included in the Accumulated PPFAC Bank Balance for purposes of calculating accrued interest.”

Q. Does Staff have any comments regarding the Company’s revised proposal?

A. Yes. Staff agrees that the avoided cost of capacity and energy should be based on a readily available market value. Staff clarifies that the energy savings should be calculated based on the difference between the non-firm market price of energy and the fuel cost to serve its native load, since the difference between the firm and the non-firm energy is already represented by capacity values calculated based upon the \$1.52 per KW/month. Staff agrees

1 that the net benefit of any wholesale value arising from the ownership of Gila 3 should also
2 be deferred. The total of the deferral benefits associated with capacity, energy, and wholesale
3 savings would continue to be included in the amounts subject to recovery via the PPFAC.
4 The deferred benefits would be compared with eligible deferred costs for consideration in a
5 future rate case.

6
7 **Q. Does Staff have any additional comments?**

8 **A.** Yes. Further discussion with UNS indicates that UNS expects the maximum amount of costs
9 subject to deferral would be approximately \$10.5 million⁶ for the period January 2015 through
10 April 2016. Accordingly, Staff concludes that the costs subject to deferral should have both
11 time and dollar limitations. The maximum amount of costs subject to deferral should be
12 \$10.5 million and that any such deferral shall cease on May 1, 2016. Any expense incurred
13 after April 30, 2016 would not be eligible for deferral.

14
15 Regarding the costs eligible for deferral, Staff recommends the exclusion of "other non-fuel
16 plant costs" proposed by the Company because the term is overly broad. Any costs eligible
17 for deferral should be specified at this time.

18
19 **IV STAFF'S ACCOUNTING ORDER RECOMMENDATIONS**

20 **Q. What are Staff's recommendations regarding the Company's proposed accounting**
21 **order?**

22 **A.** Staff recommends approval of an accounting order reflecting the Company's revised proposal
23 subject to Staff's clarifications above. Staff recommends:

24 1. That costs subject to deferral be limited to:

25 a. depreciation and amortization costs,

⁶ The Company's original estimate of \$9 million per year was revised and recalculated for the above time frame.

- 1 b. property taxes,
- 2 c. O&M expenses, and
- 3 d. carrying costs⁷ associated with owning, operating, and maintaining the plant
- 4 2. that certain benefits of owning the plant shall also be deferred,
 - 5 a. the avoided cost of capacity should be based on the readily available market value as
 - 6 proposed by the Company,
 - 7 b. that that the energy savings related to power production at Gila 3 should be calculated
 - 8 based on the difference between the non firm market price of energy and the fuel
 - 9 cost,
 - 10 c. that the net benefit of any wholesale value arising from the ownership of Gila 3
 - 11 should also be deferred,
- 12 3. that the value of deferred benefits shall be subject to inclusion in the Company's ongoing
- 13 PPFAC calculations,
- 14 4. that the deferred costs and deferred benefits shall be evaluated in a future rate proceeding,
- 15 5. that the ratepayers be held harmless for any deferred costs in excess of deferred benefits,
- 16 6. that the amount of any deferred benefits in excess of deferred costs shall be used as a
- 17 reduction to the running balance in the PPFAC arising from non - Gila 3 activity,
- 18 7. that any authorizations to defer costs shall be limited to \$10.5 million,
- 19 8. that any authorizations to defer costs shall expire no later than May 1, 2016. Any expense
- 20 incurred after April 30, 2016 would not be eligible for deferral.
- 21 9. that no prudence determination be made at this time and that the prudence of the purchase
- 22 of Gila 3 will be determined in a future rate proceeding,
- 23 10. that there shall be no carrying costs on any under-recovered PPFAC balance resulting from
- 24 the purchase of Gila 3, and

⁷ Calculated at 5 percent.

1 11. that the Company file a plan of administration within 30 days of the filing of this testimony
2 for consideration and inclusion in the final decision.

3

4 **Q. Does this conclude your direct testimony?**

5 **A. Yes.**